

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name City of Grayling	County Crawford
Fiscal Year End 06/30/06	Opinion Date 10/31/06	Date Audit Report Submitted to State 12/22/06	

We affirm that:

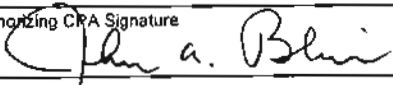
We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

- YES NO Check each applicable box below. (See instructions for further detail.)
- ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
 - ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
 - ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
 - ☒ ☐ The local unit has adopted a budget for all required funds.
 - ☒ ☐ A public hearing on the budget was held in accordance with State statute.
 - ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
 - ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
 - ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
 - ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
 - ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
 - ☒ ☐ The local unit is free of repeated comments from previous years.
 - ☒ ☐ The audit opinion is UNQUALIFIED.
 - ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
 - ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
 - ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input type="checkbox"/>	None reported	
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Hill Schroderus & Co., LLP		Telephone Number 231-347-4136	
Street Address 923 Spring St		City Petoskey	State MI
Zip 49770		License Number 1101015745	
Authorizing CPA Signature 		Printed Name John Blair	

FINANCIAL REPORT
CITY OF GRAYLING
JUNE 30, 2006

CITY OF GRAYLING
FINANCIAL REPORT
JUNE 30, 2006

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October 31, 2006

Independent Auditors' Report

Honorable Mayor, Members of
City Council and City Manager
City of Grayling, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Grayling, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the City of Grayling's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City of Grayling's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Grayling, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2006 on our consideration of the City of Grayling's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

City of Grayling
Grayling, Michigan

The management's discussion and analysis and the budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Grayling's basic financial statements. The other supplemental information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the City of Grayling. The other supplemental information and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Hill, Schroeder & Co.

CERTIFIED PUBLIC ACCOUNTANTS
Petoskey, Michigan

CITY OF GRAYLING
P.O. BOX 549
GRAYLING, MI 49738

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the CITY OF GRAYLING annual financial report presents our discussion and analysis of the entity's financial performance during the fiscal year ending June 30, 2006.

FINANCIAL HIGHLIGHTS:

Our financial status remained stable over the last year. Ending net assets for the Governmental Funds total \$7,980,314 during this fiscal year, which reflects an increase of \$34,953.

Overall revenues for Governmental Funds were \$2,250,579. In addition, we booked Grant Revenue of \$191,512. Total expenses for the year were \$2,452,500, which reflected an excess expense of revenue vs. expenditures of \$10,409.

In 1994, the people of Michigan approved Proposal A. The change to the state's tax structure created an assessed value and a taxable value for each parcel. The SEV, is 50% of the true cash value of a piece of land and its improvements. Value continues to rise as the value of property increases. The increase in taxable value is capped at the rate of inflation or 5%, whichever is smaller, as long as the owner does not sell the property. Upon a sale, the property is reassessed and the new taxable value will typically be the same as the assessed value.

Property taxes are based on the taxable value not the assessed value. If there is no growth or improvements in the City, the property tax revenue will only increase by the rate of inflation. Most townships are experiencing a much greater growth in their property tax revenue, due to the fact new development is taking place in rural communities rather than cities.

Our 2005 taxable value increased by 5.42% during the last year, from \$52,401,189 to \$55,238,791. Assessed Value only increased 3.15%, from \$66,185,423 to \$68,268,900. A notable taxable increase would seem to indicate increased growth, however we had favorable rulings from the Michigan Tax Tribunal for omitted property that was overlooked by previous assessors.

OVERVIEW OF THE FINANCIAL STATEMENTS:

This annual report consists of three parts: management's discussion and analysis, the basic financial statements and other supplementary information. The basic financial statements include two different types of statements that present different views of the entity.

The first two statements are entity-wide financial statements and provide both long- and short-term information about our overall financial status. These statements present governmental activities and/or business-type activities.

The remaining statements are fund financial statements which focus on individual parts of the entity in more detail.

The notes to the financial statements explain some of the information in the statements and provide more detailed data.

The supplemental information further explains and supports the financial statement information.

ENTITY-WIDE STATEMENTS:

The entity-wide statements report information about the entity as a whole using accounting methods used by private companies. The Statement of Net Assets includes all of the entity's assets and liabilities. The Statement of Activities records all of the current year revenues and expenses, regardless of when received or paid.

The two entity-wide statements report net assets and how they have changed. Net assets are the difference between the entity's assets and liabilities. This is one method to measure the entity's financial health or position. Over time, increases and decreases in the entity's net assets are an indicator of whether financial position is improving or deteriorating.

To assess overall health of the entity you may also have to consider additional factors such as tax base changes, facility conditions and personnel changes.

FUND FINANCIAL STATEMENTS:

The fund financial statements provide more detailed information about the entity's funds, focusing on significant (major) funds and not the entity as a whole. Funds are used to account for specific activities or funding sources. Some funds are required by law or bond covenants. They also may be created by the entity's board. Funds are established to account for funding and spending of specific financial resources and to show proper expenditure of those resources.

The entity has the following types of funds:

GOVERNMENTAL FUNDS - Most of the entity's activities are included in the governmental fund category. These funds are presented on the modified accrual basis, which is designed to show short-term financial information. You will note that differences between the entity-wide statements and the fund statements are disclosed to explain the differences between them.

PROPRIETARY FUNDS - These funds represent activities in the government, which are basically treated like private sector companies. These funds are designed to have revenues earned adequate to pay for the operations of the activity. These funds are presented on a full accrual method and will show little difference from the entity-wide statement presentation.

FIDUCIARY FUNDS - The entity is a trustee or fiduciary for assets that belong to others. The entity maintains these funds and is responsible for ensuring that the assets of these activities are spent for their intended purpose and at the direction of those to whom the funds belong. These activities do not appear in the entity-wide financial statements since the assets do not belong to the entity.

FINANCIAL ANALYSIS OF THE ENTITY'S FUNDS:

101 General Fund

The General Fund is the City's main bank account. It collects all money that the law does not require to be accounted for in a separate fund. It also pays all the bills that do not fall within another fund. The General Fund covers the widest range of activities in any city. In Grayling, it pays for all city services except streets, equipment, water and sewer.

The General Fund had a Fund Balance of \$1,961,807 June 30, 2006 designated funds are as follows:

Cemetery restricted	\$435,953
Fire protection	84,254
Unfunded Pension	417,535
Undesignated funds	1,024,065

Capital projects for the fiscal year were as follows:

Park Project	\$ 44,195	in Progress
Ice Rink Surface	2,160	Completed
Cemetery Expansion	89,253	Completed

We received funds from the Enterprise Grant of \$15,360 for the DDA, funds from the Brownfield Grant in the amount of \$96,152, and the Military contributed \$80,000 to fund a fulltime person at the Fire Department, in addition to provide funds to purchase emergency equipment and training for protection on the airfield. The Military contribution is an annual agreement and is not guaranteed to continue.

Wages were increased by 3% for all nonunion employees. All union employee wages increased according to their contracts. Fringe benefits and payroll taxes have increased accordingly. BCBS continued to increase, up 12%. MERS costs have leveled out with only minor increases for two divisions. Non-Union division increased .68%, Police Union increase .12%, and DPW Union decreased .86%. The ratio of the Valuation Assets to the Actuarial Accrued Liability as of December 31, 2005 is 84%, with an unfunded liability of \$417,535.

Expenditures were allocated as follows:

Culture and Recreation	\$ 63,555
General Government	831,368
Legislative & Legal	19,390
Public Safety	751,823
Public works	146,858
Total	\$ 1,812,994

202 Major Streets & 203 Local Streets

The State of Michigan classifies all city streets as Major and Local Streets. The classification is based on criteria that include width, parking restrictions, connections to state trunk lines and traffic count. Major Streets are eligible for increased funding from the state. This year we received PA 51 Funds of \$98,402 for Major Streets and \$45,046 for Local Streets. The street funds receive money from the state that is raised from gasoline taxes. This money must be used for construction and maintenance of city streets. The revenue for these classifications must be kept in separate funds.

This state money does not cover the total cost of streets for any city. Each year, money is transferred from the General Fund to pay for the cost of maintenance and snow removal. We transferred \$195,705 to Local Streets and we anticipate a transfer of \$33,000 to Local Streets next year fiscal year.

Fund Balance for Major Streets as of June 30, 2006 was \$130,378, and Local Streets had a balance of \$14,837. The State of Michigan allows a transfer up to 25% of Major Street Fund Equity to Local Streets for operation.

The major streets in the City include:

- Industrial Drive
- Hanson
- Dupont
- Salling
- Lake
- Maple
- State
- Michigan
- Peninsular
- Norway
- One block of Ionia from Cedar to Peninsular

All other city streets are classified as local streets.

211 Income Tax

The Income Tax Fund collects the revenue from the city Income Tax. In 1972, the voters approved the ordinance, which limited expenditures from the fund to street and storm sewer construction. This is a 1% tax on income of city residents and ½ % on the income others earn in the city. Then in 2002 the voters expanded the use of these funds for any capital improvements within the City. It is important that the Income Tax Fund always has sufficient money to pay for necessary street and sidewalk improvements, which was the original intent of the ordinance that the residents approved. City Council adopted the policy establishing a minimum amount of \$215,000 to be retained in the Income Tax Fund for such needed improvements.

The fund balance as of June 30, 2006 was \$931,909.

The 2006-2007 anticipated capital projects include:

Reserved for Streetscape project	\$	60,000
Reserved for Park Improvements		193,988
Reserved for Stormwater improvements		43,000
Reserved for Equipment Internal Service		100,000
Reserved for well improvement		35,500
Retained Fund Balance	\$	215,000 (per City Council 04-265)
Undesignated Income Tax funds	\$	284,421

Revenues were 100% of anticipated budget. We continue to pursue diligent enforcement and consistent disbursement of information to our residents and business owners. With anticipated growth we are confident our income projections are realistic, however if the growth is delayed the anticipated revenues could fall short of projections.

Many projects have been discussed for future years, such as Michigan Ave. Streetscape. These projects have not been included in the designated funds. The City must be very cautious about over extending the Income Tax Fund. We must also keep in mind cash flow trends in this Fund. The majority of the revenue is collected in the middle of the fiscal year, therefore we must maintain a healthy fund balance to operate.

370 Bond Debt Fund

This Fund is used to pay our General Fund obligations. A transfer from the General Fund is made to the Bond Debt Fund to cover this obligation.

470 Capital Construction Fund

This fund was initially set up to track all expenses relating to the construction of the new City Hall. Since the project is complete this fund is no longer needed. We can use it in the future if a construction project is needed.

590 Sewer Fund and 591 Water Fund

Water & Sewer Fund accounts for the City providing water and sewer services to the residents and businesses in the City. Revenue is provided primarily through user fees. The state requires that revenues in this fund must cover any costs for the services.

Revenues fell short of projections 8.60% for Sewer and 5.10% for Water. Grant Revenue for the Water Fund totaled \$168,386 for Maple St. and \$ 385,694 in the Sewer Fund for the Stormwater project.

Expenditures were allocated as follows:

	<u>Sewer</u>	<u>Water</u>
Operations	\$217,237	\$138,550
Repairs & maintenance	26,677	27,580
Depreciation	130,321	29,747
Capital Improvements	447,544	265,715

We increased our net assets in the amount of \$566,242. The Stormwater project added \$428,359 to construction in progress. Maple Street construction added \$227,749. The Southside/Lawndale & Fulton Project added \$39,135 and was completed in the 05-06 fiscal year, and finally we renovated one of our wells to add \$18,000. Again we were very productive and continue to replace old infrastructure in an effort to provide continued reliability in our water and sewer system.

We are confident that with continued State and Federal Grant support and annual rate increases, we will improve our financial position.

661 Internal Service Fund

Think of the Internal Service Fund as the City's motor pool. It accounts for the cost of acquiring, maintaining, and providing vehicles and equipment for various City departments. This includes the cost of buildings to house that equipment. Each department pays a rental charge to the fund for their use of its equipment. This allows the Internal Service Fund to replace City equipment when necessary.

Its initial balance was a transfer from the General Fund. The revenue from equipment rental does not cover the cost of purchasing equipment or depreciation. The rental revenue covers the cost of maintaining, repairing and fueling the equipment. Over the years, the General Fund has transferred money to the Internal Service Fund on a regular basis. This money has been used for the purchase of the equipment.

Total Balances and Reserves as of June 30, 2006 was \$766,537, however \$561,165 is property plant & equipment and is not a liquid asset. We anticipate the level of transfers from the Income Tax Fund to be \$100,000 for the purchase of a new plow truck.

CONDENSED FINANCIAL STATEMENT INFORMATION:

City of Grayling
Changes in Net Assets
June 30, 2006 and 2005

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenue						
Program revenues:						
Charges for services	\$ 265,671	\$ 223,750	\$ 563,756	\$ 611,539	\$ 829,427	\$ 835,289
Operating grants and contributions	143,448	159,842	568,084	31,591	711,532	191,433
Capital grants and contributions	192,227	932,494	-	-	192,227	932,494
General revenues:						
Property taxes	842,380	780,687	-	-	842,380	780,687
Income taxes	406,780	432,194	-	-	406,780	432,194
Sales taxes	229,092	231,735	-	-	229,092	231,735
Alcohol beverage taxes	5,586	5,567	-	-	5,586	5,567
Unrestricted investment earnings	270,258	221,574	41,214	16,451	311,472	238,025
Sale of property	18,394	59,085	-	-	18,394	59,085
Other	36,543	21,215	-	-	36,543	21,215
Transfers	(43,000)	(359,605)	43,000	359,605	-	-
Total revenues	2,367,379	2,708,538	1,216,054	1,019,186	3,583,433	3,727,724
Function/Program Expenses						
Legislative	19,390	20,483	-	-	19,390	20,483
General government	854,572	910,151	-	-	854,572	910,151
Public safety	785,070	699,807	-	-	785,070	699,807
Public works	165,461	152,500	-	-	165,461	152,500
Highways and streets	481,738	533,844	-	-	481,738	533,844
Culture and recreation	19,192	22,257	-	-	19,192	22,257
Debt service	51,499	43,442	-	-	51,499	43,442
Water and sewer	-	-	649,812	611,725	649,812	611,725
Total expenses	2,376,922	2,382,484	649,812	611,725	3,026,734	2,994,209
Change in net assets	(9543)	326,054	566,242	407,461	556,699	733,515
Net assets – beginning of year	7,945,361	7,619,307	4,999,682	4,592,221	12,945,043	12,211,528
Prior period adjustment	44,496	-	-	-	44,496	-
Net assets – end of year	\$ 7,980,314	\$ 7,945,361	\$ 5,565,924	\$ 4,999,682	\$ 13,546,238	\$ 12,945,043

City of Grayling
Statement of Net Assets
June 30, 2006 and 2005

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Assets						
Current and other assets	\$ 3,504,482	\$ 3,693,208	\$ 977,041	\$ 1,365,781	\$ 4,481,503	\$ 5,058,989
Capital assets - net of accum. dep.	5,829,218	5,855,346	6,253,002	5,599,330	12,092,220	11,454,676
Total assets	\$ 9,333,680	\$ 9,548,554	\$ 7,240,043	\$ 6,965,111	\$ 16,573,723	\$ 16,513,665
Liabilities						
Current liabilities	351,857	732,044	112,119	371,429	463,976	1,103,473
Bonds payable, long-term portion	1,001,509	871,149	1,562,000	1,594,000	2,563,509	2,465,149
Total liabilities	1,353,366	1,603,193	1,674,119	1,965,429	3,027,485	3,568,622
Net Assets						
Investment in capital assets						
net of related debt	4,810,009	4,777,823	4,558,522	3,973,330	9,368,531	8,751,153
Restricted	-	-	110,480	90,004	110,480	90,004
Unrestricted	3,170,305	3,167,535	896,922	936,348	4,067,227	4,103,886
Total net assets	7,980,314	7,945,361	5,555,924	4,999,682	13,546,238	12,945,043
Total liabilities and net assets	\$ 9,333,680	\$ 9,548,554	\$ 7,240,043	\$ 6,965,111	\$ 16,573,723	\$ 16,513,665

Long-term Debt

Governmental Activities: \$1,019,209

Business-type Activities: \$1,594, 000

Analysis of Original budget to Actual and Amended

Final budgeted revenues and expenditures increased from original budgeted amounts. Approximately \$245,000 of the contingency was tapped for increases in budgeted expenditures.

Final actual revenues were slightly over final budgeted amounts.

Final actual expenditures were less than final budgeted amounts. The largest budget variances was in public safety for \$25,000 for capital improvements that was not expensed

KNOWN FACTORS AFFECTING FUTURE OPERATIONS:

We have several projects that will be completed in the next fiscal year. Unfortunately we do not have final completion numbers on every project. However, we believe we have provided the most accurate numbers possible.

CONTACTING ENTITY MANAGEMENT:

This financial report is designed to provide our taxpayers, creditors, investors and interested parties with a general overview of the entity's finances and to demonstrate the entity's accountability for the revenues it receives. If you have questions concerning this report, please contact CITY OF GRAYLING, PO BOX 549, GRAYLING, MI 49738 or call (989) 348-2131

Terry McGregor, Treasurer

CITY OF GRAYLING
Statement of Net Assets
June 30, 2006

<u>Assets</u>	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Current Assets			
Cash	\$ 2,677,170	\$ 485,678	\$ 3,162,848
Investments	690,745	250,000	940,745
Accounts receivable	-	222,465	222,465
Taxes receivable	1,845	-	1,845
Due from fiduciary fund	45	-	45
Due from other governmental units	134,657	-	134,657
Inventory	-	18,898	18,898
	<hr/>	<hr/>	<hr/>
Total current assets	3,504,462	977,041	4,481,503
	<hr/>	<hr/>	<hr/>
Noncurrent Assets			
Restricted cash	-	110,480	110,480
Land	215,764	-	215,764
Buildings	2,136,681	-	2,136,681
Machinery and equipment	2,842,529	8,605,265	11,447,794
Infrastructure	8,095,746	-	8,095,746
Construction in progress	81,710	575,429	657,139
Less: accumulated depreciation	(7,543,212)	(3,028,172)	(10,571,384)
	<hr/>	<hr/>	<hr/>
Total noncurrent assets	5,829,218	6,263,002	12,092,220
	<hr/>	<hr/>	<hr/>
Total assets	<u>\$ 9,333,680</u>	<u>\$ 7,240,043</u>	<u>\$ 16,573,723</u>

CITY OF GRAYLING
Statement of Net Assets
(Continued)
June 30, 2006

<u>Liabilities and Net Assets</u>	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Current Liabilities			
Accrued expenses	\$ 9,119	\$ 2,091	\$ 11,210
Accounts payable	71,258	38,178	109,436
Accrued interest payable	16,820	39,850	56,670
Due to other governmental units	19,121	-	19,121
Deferred revenue	164,152	-	164,152
Notes payable, due within one year	41,387	-	41,387
Bonds payable, due within one year	30,000	32,000	62,000
	<hr/>	<hr/>	<hr/>
Total current liabilities	351,857	112,119	463,976
	<hr/>	<hr/>	<hr/>
Noncurrent Liabilities			
Compensated absences payable	53,687	-	53,687
Notes payable	157,822	-	157,822
Bonds payable	790,000	1,562,000	2,352,000
	<hr/>	<hr/>	<hr/>
Total noncurrent liabilities	1,001,509	1,562,000	2,563,509
	<hr/>	<hr/>	<hr/>
Total liabilities	1,353,366	1,674,119	3,027,485
	<hr/>	<hr/>	<hr/>
Net Assets			
Invested in capital assets, net of related debt	4,810,009	4,558,522	9,368,531
Restricted	-	110,480	110,480
Unrestricted	3,170,305	896,922	4,067,227
	<hr/>	<hr/>	<hr/>
Total net assets	7,980,314	5,565,924	13,546,238
	<hr/>	<hr/>	<hr/>
Total liabilities and net assets	<u>\$ 9,333,680</u>	<u>\$ 7,240,043</u>	<u>\$ 16,573,723</u>

CITY OF GRAYLING
Statement of Activities
For the Year Ended June 30, 2006

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities
Primary Government						
Governmental activities:						
Legislative	\$ 19,390	\$ -	\$ -	-	\$ (19,390)	\$ -
General government	854,572	265,671	-	192,227	(396,674)	-
Public safety	785,070	-	-	-	(785,070)	-
Public works	165,461	-	-	-	(165,461)	-
Highways and streets	481,738	-	143,448	-	(338,290)	-
Culture and recreation	19,192	-	-	-	(19,192)	-
Debt service	51,499	-	-	-	(51,499)	-
Total governmental activities	2,376,922	265,671	143,448	192,227	(1,775,576)	-
Business-type activities:						
Sewer	422,055	363,806	394,745	-	-	336,496
Water	227,757	199,950	173,339	-	-	145,532
Total primary government	\$ 3,026,734	\$ 829,427	\$ 711,532	\$ 192,227	(1,775,576)	482,028
General revenues:						
Property taxes					842,380	-
Income taxes					406,780	-
Sales taxes					229,092	-
Alcoholic beverage taxes					5,586	-
Unrestricted investment earnings					270,258	41,214
Sale of property					18,394	-
Other					36,543	-
Transfers					(43,000)	43,000
Total general revenues and transfers					1,766,033	84,214
Change in net assets					(9,543)	556,699
Net assets - beginning of year					7,945,361	4,999,682
Prior period adjustment					44,496	-
Net assets - end of year					\$ 7,980,314	\$ 5,565,924
						\$ 13,546,238

See accompanying notes to the basic financial statements

CITY OF GRAYLING
Balance Sheet
Governmental Funds
June 30, 2006

<u>Assets</u>	General	Major Street	Local Street
Cash	\$ 1,218,501	\$ 117,038	\$ 8,686
Investments	690,745	-	-
Taxes receivable	1,845	-	-
Due from other funds	31,165	-	-
Due from other governmental units	110,957	16,200	7,500
Total assets	<u>\$ 2,053,213</u>	<u>\$ 133,238</u>	<u>\$ 16,186</u>
<u>Liabilities and Fund Balances</u>			
Liabilities			
Accrued expenditures	\$ 6,621	\$ 873	\$ 934
Accounts payable	65,664	1,987	415
Due to other funds	-	-	-
Due to other governmental units	19,121	-	-
Deferred revenue	-	-	-
Total liabilities	<u>91,406</u>	<u>2,860</u>	<u>1,349</u>
Fund balances			
Unreserved, designated for:			
Cemetery expenditures	435,953	-	-
Fire protection expenditures	84,254	-	-
Unfunded pension	417,535	-	-
Streetscape grant	-	-	-
Recreation	-	-	-
Equipment	-	-	-
Storm water	-	-	-
Well improvement	-	-	-
Unreserved, undesignated:			
General fund	1,024,065	-	-
Special revenue funds	-	130,378	14,837
Total fund balances	<u>1,961,807</u>	<u>130,378</u>	<u>14,837</u>
Total liabilities and fund balances	<u>\$ 2,053,213</u>	<u>\$ 133,238</u>	<u>\$ 16,186</u>

See accompanying notes to the basic financial statements.

Income Tax	Other Nonmajor Governmental Funds	Total Governmental Funds
\$ 1,127,573	\$ -	\$ 2,471,798
-	-	690,745
-	-	1,845
-	-	31,165
-	-	134,657
<u>\$ 1,127,573</u>	<u>\$ -</u>	<u>\$ 3,330,210</u>
\$ -	\$ -	\$ 8,428
392	-	68,458
31,120	-	31,120
-	-	19,121
164,152	-	164,152
<u>195,664</u>	<u>-</u>	<u>291,279</u>
-	-	435,953
-	-	84,254
-	-	417,535
60,000	-	60,000
193,988	-	193,988
100,000	-	100,000
43,000	-	43,000
35,500	-	35,500
-	-	1,024,065
499,421	-	644,636
<u>931,909</u>	<u>-</u>	<u>3,038,931</u>
<u>\$ 1,127,573</u>	<u>\$ -</u>	<u>\$ 3,330,210</u>

CITY OF GRAYLING
Reconciliation of Governmental Funds Balance Sheet to the
Statement of Net Assets
June 30, 2006

Total Fund Balance - Governmental Funds	\$ 3,038,931
Amounts reported for governmental activities in the statement of net assets are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of net assets, these assets are capitalized and depreciated over their estimated useful lives.	
Governmental capital assets	12,358,597
Accumulated depreciation	(7,090,544)
Governmental funds report interest when due, whereas in the statement of net assets, interest is accrued on outstanding bonds.	
	(16,820)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds.	
Governmental bonds payable	(820,000)
Governmental notes payable	(199,209)
Compensated absences	(53,687)
The Internal Service Fund is used to charge motor vehicle usage costs to various departments within the City. The assets and liabilities of the Internal Service Fund are included in governmental activities in the statement of net assets.	
	<u>763,046</u>
Net Assets of Governmental Activities	<u>\$ 7,980,314</u>

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2006

	General	Major Street	Local Street
Revenues			
Taxes	\$ 842,380	\$ -	\$ -
Federal revenue	15,360	-	-
State revenue	411,545	98,402	45,046
Charges for services	265,671	-	-
Interest and rentals	221,197	4,957	914
Other	33,884	2,659	-
Intergovernmental revenues	56,530	-	-
	<hr/>	<hr/>	<hr/>
Total revenues	1,846,567	106,018	45,960
	<hr/>	<hr/>	<hr/>
Expenditures			
Current:			
Culture and recreation	63,555	-	-
General government	831,368	-	-
Highways and streets	-	151,815	245,840
Legislative	19,390	-	-
Public safety	751,823	-	-
Public works	143,413	-	-
Debt service:			
Interest	-	-	-
Principal retirement	-	-	-
Capital outlay:			
Public safety	3,445	-	-
	<hr/>	<hr/>	<hr/>
Total expenditures	1,812,994	151,815	245,840
	<hr/>	<hr/>	<hr/>
Excess (deficiency) of revenues over expenditures	33,573	(45,797)	(199,880)
	<hr/>	<hr/>	<hr/>
Other financing sources (uses)			
Transfers in	41,605	-	195,705
Transfers out	(164,669)	-	-
Sale of property	18,394	-	-
	<hr/>	<hr/>	<hr/>
Total other financing sources (uses)	(104,670)	-	195,705
	<hr/>	<hr/>	<hr/>
Net change in fund balances	(71,097)	(45,797)	(4,175)
	<hr/>	<hr/>	<hr/>
Fund balances - beginning of year	1,988,408	176,175	19,012
	<hr/>	<hr/>	<hr/>
Prior period adjustment	44,496	-	-
	<hr/>	<hr/>	<hr/>
Fund balances - end of year	\$ 1,961,807	\$ 130,378	\$ 14,837
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes to the basic financial statements.

Income Tax	Other Nonmajor Governmental Funds	Total Governmental Funds
\$ 406,780	\$ -	\$ 1,249,160
-	-	15,360
-	-	554,993
-	-	265,671
36,766	-	263,834
-	-	36,543
-	-	56,530
443,546	-	2,442,091
-	-	63,555
140,419	-	971,787
-	-	397,655
-	-	19,390
-	-	751,823
-	-	143,413
-	43,164	43,164
-	58,268	58,268
-	-	3,445
140,419	101,432	2,452,500
303,127	(101,432)	(10,409)
-	101,432	338,742
(223,434)	-	(388,103)
-	-	18,394
(223,434)	101,432	(30,967)
79,693	-	(41,376)
852,216	-	3,035,811
-	-	44,496
\$ 931,909	\$ -	\$ 3,038,931

CITY OF GRAYLING
Reconciliation of the Statement of Revenues, Expenditures, and
Changes in Fund Balances of Governmental Funds to the
Statement of Activities
For the Year Ended June 30, 2006

Net Change in Fund Balances - Total Governmental Funds	\$ (41,376)
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Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of these assets is allocated over their estimated useful lives as depreciation.

Expenditures for capital assets	336,383
Current year depreciation	(386,403)

Repayment of bond and note principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount of principal paid on long-term debt.	51,148
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Interest on long-term debt is recognized as an expenditure when it is due in the governmental funds. However, in the statement of activities, interest expense is recognized as the interest accrues, regardless of when it is due.	(1,215)
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Compensated absences are recognized as an expenditure when it is paid in the governmental funds. In the statement of activities, however, compensated absences are recognized as an expense when earned.	(2,538)
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The Internal Service Fund is used to charge motor vehicle usage costs to various departments within the city. The net revenue (expense) of the Internal Service Fund is included in governmental activities in the statement of activities. Depreciation is excluded from this adjustment due to inclusion above.	34,458
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Change in Net Assets of Governmental Activities	\$ (9,543)
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CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
General Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Over/(Under)
	Original	Final		
Revenues				
Taxes	\$ 811,800	\$ 811,800	\$ 842,380	\$ 30,580
Federal revenue	146,000	117,000	15,360	(101,640)
State revenue	232,775	312,775	411,545	98,770
Charges for services	285,984	285,984	265,671	(20,313)
Interest and rentals	200,981	236,981	221,197	(15,784)
Other	6,000	22,405	33,884	11,479
Intergovernmental revenues	56,531	56,531	56,530	(1)
Total revenues	1,740,071	1,843,476	1,846,567	3,091
Expenditures				
Current:				
Culture and recreation	155,925	69,400	63,555	(5,845)
General government	655,060	860,138	831,368	(28,770)
Legislative	21,800	21,800	19,390	(2,410)
Public safety	591,560	806,193	751,823	(54,370)
Public works	167,840	140,254	143,413	3,159
Capital outlay:				
Public safety	63,500	3,445	3,445	-
Total expenditures	1,655,685	1,901,230	1,812,994	(88,236)
Excess (deficiency) of revenues over expenditures	84,386	(57,754)	33,573	91,327
Other financing sources (uses)				
Sale of property	30,000	30,000	18,394	(11,606)
Transfers in	86,325	50,300	41,605	(8,695)
Transfers out	(151,274)	(169,178)	(164,669)	4,509
Total other financing sources (uses)	(34,949)	(88,878)	(104,670)	(15,792)
Net change in fund balance	49,437	(146,632)	(71,097)	75,535
Fund balance - beginning of year	1,995,454	1,799,385	1,988,408	189,023
Prior period adjustment	-	-	44,496	44,496
Fund balance - end of year	\$ 2,044,891	\$ 1,652,753	\$ 1,961,807	\$ 309,054

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
Major Street Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Over/(Under)
	Original	Final		
Revenues				
State revenue	\$ 102,400	\$ 102,400	\$ 98,402	\$ (3,998)
Interest and rentals	2,000	4,500	4,957	457
Miscellaneous Income	-	2,500	2,659	159
Total revenues	104,400	109,400	106,018	(3,382)
Expenditures				
Current:				
Highways and streets	152,057	162,057	151,815	(10,242)
Excess (deficiency) of revenues over expenditures	(47,657)	(52,657)	(45,797)	6,860
Net change in fund balance	(47,657)	(52,657)	(45,797)	6,860
Fund balance - beginning of year	176,175	176,175	176,175	-
Fund balance - end of year	\$ 128,518	\$ 123,518	\$ 130,378	\$ 6,860

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
Local Street Fund
For the Year Ended June 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with Final Budget Over/(Under)
	Original	Final		
Revenues				
State revenue	\$ 47,040	\$ 47,040	\$ 45,046	\$ (1,994)
Interest and rentals	400	400	914	514
Total revenues	47,440	47,440	45,960	(1,480)
Expenditures				
Current:				
Highways and streets	123,326	248,348	245,840	(2,508)
Excess (deficiency) of revenues over expenditures	(75,886)	(200,908)	(199,880)	1,028
Other financing sources (uses)				
Transfers in	45,886	194,890	195,705	815
Net change in fund balance	(30,000)	(6,018)	(4,175)	1,843
Fund balance - beginning of year	19,012	19,012	19,012	-
Fund balance - end of year	<u>\$ (10,988)</u>	<u>\$ 12,994</u>	<u>\$ 14,837</u>	<u>\$ 1,843</u>

CITY OF GRAYLING
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual
Income Tax Fund
For the Year Ended June 30, 2006

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget Over/(Under)</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 405,000	\$ 405,000	\$ 406,780	\$ 1,780
Interest and rentals	13,000	33,000	36,766	3,766
Capital Contributions	-	216,975	-	(216,975)
	<u>418,000</u>	<u>654,975</u>	<u>443,546</u>	<u>(211,429)</u>
Expenditures				
Current:				
General government	<u>109,323</u>	<u>158,721</u>	<u>140,419</u>	<u>(18,302)</u>
Excess (deficiency) of revenues over expenditures	<u>308,677</u>	<u>496,254</u>	<u>303,127</u>	<u>(193,127)</u>
Other financing sources (uses)				
Transfers out	<u>(129,325)</u>	<u>(231,314)</u>	<u>(223,434)</u>	<u>7,880</u>
Net change in fund balance	<u>179,352</u>	<u>264,940</u>	<u>79,693</u>	<u>(185,247)</u>
Fund balance - beginning of year	<u>1,367,301</u>	<u>1,452,889</u>	<u>852,216</u>	<u>(600,673)</u>
Fund balance - end of year	<u>\$ 1,546,653</u>	<u>\$ 1,717,829</u>	<u>\$ 931,909</u>	<u>\$ (785,920)</u>

CITY OF GRAYLING
Statement of Net Assets
Proprietary Funds
June 30, 2006

<u>Assets</u>	Business-type Activities - Enterprise Fund Sewer	Business-type Activities - Enterprise Fund Water	Governmental Activities - Internal Service Fund
Current Assets			
Cash	\$ 410,340	\$ 75,338	\$ 205,372
Investments	162,500	87,500	-
Accounts receivable	159,896	62,569	-
Inventory	12,285	6,613	-
Total current assets	<u>745,021</u>	<u>232,020</u>	<u>205,372</u>
Noncurrent Assets			
Restricted cash	49,560	60,920	-
Construction in progress	575,429	-	-
Machinery and equipment	6,848,428	1,756,837	1,013,833
Less: accumulated depreciation	<u>(2,122,569)</u>	<u>(905,603)</u>	<u>(452,668)</u>
Total noncurrent assets	<u>5,350,848</u>	<u>912,154</u>	<u>561,165</u>
Total assets	<u><u>\$ 6,095,869</u></u>	<u><u>\$ 1,144,174</u></u>	<u><u>\$ 766,537</u></u>
 <u>Liabilities and Net Assets</u>			
Current Liabilities			
Accrued expenses	\$ 1,229	\$ 862	\$ 691
Accounts payable	36,661	1,517	2,800
Accrued interest	23,910	15,940	-
Bonds payable - current	<u>19,200</u>	<u>12,800</u>	<u>-</u>
Total current liabilities	81,000	31,119	3,491
Noncurrent Liabilities			
Bonds payable	<u>937,200</u>	<u>624,800</u>	<u>-</u>
Total liabilities	<u>1,018,200</u>	<u>655,919</u>	<u>3,491</u>
Net Assets			
Invested in capital assets, net of related debt	4,344,888	213,634	561,165
Restricted for capital improvements	23,800	47,300	-
Restricted for bond covenants	25,760	13,620	-
Unrestricted	<u>683,221</u>	<u>213,701</u>	<u>201,881</u>
Total net assets	<u>5,077,669</u>	<u>488,255</u>	<u>763,046</u>
Total liabilities and net assets	<u><u>\$ 6,095,869</u></u>	<u><u>\$ 1,144,174</u></u>	<u><u>\$ 766,537</u></u>

CITY OF GRAYLING
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2006

	Business-type Activities- Enterprise Fund Sewer	Business-type Activities - Enterprise Fund Water	Governmental Activities - Internal Service Fund
Operating revenues			
Charges for services	363,806	\$ 199,950	\$ 181,695
Operating expenses			
Personnel	93,026	79,049	65,366
Contractual	86,281	34,795	18,286
Supplies	4,353	8,774	37,845
Utilities	33,577	15,932	10,917
Repair & maintenance	26,677	27,580	33,969
Depreciation	130,321	29,747	56,181
Total operating expenses	374,235	195,877	222,564
Operating income (loss)	(10,429)	4,073	(40,869)
Nonoperating revenues			
Interest and rentals	17,119	24,095	6,424
Federal revenues	-	168,386	-
State revenues	394,745	4,953	-
Total nonoperating revenues	411,864	197,434	6,424
Nonoperating expenses			
Interest	(47,820)	(31,880)	-
Total nonoperating revenues (expenses)	364,044	165,554	6,424
Income (loss) before operating transfers and capital contributions	353,615	169,627	(34,445)
Operating transfers in	43,000	-	6,361
Change in net assets	396,615	169,627	(28,084)
Total net assets - beginning	4,681,054	318,628	791,130
Total net assets - ending	\$ 5,077,669	\$ 488,255	\$ 763,046

CITY OF GRAYLING
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2006

	Business-type Activities - Enterprise Fund Sewer	Business-type Activities - Enterprise Fund Water	Governmental Activities - Internal Service Fund
Cash flows from operating activities			
Cash received from customers	\$ 327,322	\$ 200,733	\$ -
Receipts from interfund services provided	-	-	181,695
Payments to employees	(94,990)	(79,907)	(65,864)
Payments to suppliers	(234,891)	(162,038)	(92,863)
Payments for interfund services used	(69,548)	(25,990)	(9,834)
Net cash provided (used) by operating activities	(72,107)	(67,202)	13,134
Cash flows from non-capital financing activities			
Subsidy from federal/state grant	394,745	173,339	-
Cash flows from capital and related financing activities			
Transfer from other funds	46,750	-	6,361
Acquisition and construction of capital assets	(447,545)	(265,715)	(24,697)
Interest paid on revenue bonds	(48,228)	(32,272)	-
Principal paid on revenue bonds	(19,200)	(12,800)	-
Net cash provided (used) for capital investing activities	(468,223)	(310,787)	(18,336)
Cash flows from investing activities			
Interest received	17,119	24,095	6,424
Purchase of investments	(3,250)	(1,750)	-
Net cash provided (used by investing activities)	13,869	22,345	6,424
Net increase (decrease) in cash	(131,716)	(182,305)	1,222
Cash, beginning	591,616	318,563	204,150
Cash, ending	\$ 459,900	\$ 136,258	\$ 205,372
Reconciliation of operating income to net cash provided (used) by operating activities			
Operating income (loss)	\$ (10,429)	\$ 4,073	\$ (40,869)
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	130,321	29,747	56,181
(Increase) decrease in customer receivables	(36,484)	783	-
(Increase) decrease in prepaid expenses	723	389	1,085
Increase (decrease) in accounts payable	(153,551)	(100,947)	(1,680)
Increase (decrease) in accrued expenses	(2,687)	(1,247)	(1,583)
Total adjustments	(61,678)	(71,275)	54,003
Net cash provided (used) by operating activities	\$ (72,107)	\$ (67,202)	\$ 13,134

CITY OF GRAYLING
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2006

		<u>Agency Fund</u>
<u>Assets</u>		
Cash		\$ 45
<u>Liabilities</u>		
Due to other funds		\$ 45

CITY OF GRAYLING
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Grayling ("the City") was incorporated in May 1935 under the provisions of Act 279, P.A. 1909, as amended (Home Rule City Act). The City operates under a Council-Manager form of government and provides the following services as authorized by its charter: public safety (police and fire), highways and streets, cemetery, sanitation, health and social services, culture and recreation, public improvements, planning and zoning, and general administrative services.

The City's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The City's reporting entity applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. Proprietary funds and similar component units apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. Pronouncements of the FASB issued after November 30, 1989 are not applied in the preparation of the financial statements of the proprietary funds in accordance with GASB Statement No. 20. The following is a summary of the significant policies used by the City of Grayling:

REPORTING ENTITY

The accompanying financial statements have been prepared in accordance with criteria established by GASB No. 14, and amended by GASBS No. 39. GASBS 14 states that the primary basis for determining whether outside agencies and organizations should be considered component units of the City and included in the City's financial statements is financial accountability. Financial accountability has been defined as follows: A primary government has substantive authority to appoint a voting majority of the component unit's board; the primary government is either able to impose its will on a component unit or there is a potential for the component unit to provide specific financial burdens on the primary government; and the component unit is fiscally dependent on the primary government. The City has no component units.

RELATED ORGANIZATION

The Grayling Housing Commission ("the Commission") is governed by a five-member board appointed by the Grayling City Council. The Commission is legally separate and not financially accountable to the City of Grayling, thus it is not shown as part of the City's financial statements. Complete financial statements for the Commission can be obtained from its administrative office.

BASIC FINANCIAL STATEMENTS – OVERVIEW

The City of Grayling's basic financial statements include both government-wide (reporting the City as a whole) and fund financial statements (reporting the City's major funds). Both the government-wide and the fund financial statements categorize primary government activities as either governmental or business-type. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. The primary government is reported separately from legally separate component units for which the primary government is financially accountable. The City has no component units.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

BASIC FINANCIAL STATEMENTS – GOVERNMENT-WIDE STATEMENTS

The government-wide financial statements report information on all of the non-fiduciary activities of the primary government and its component units. As a general rule the effect of interfund activity, such as overhead costs, has been eliminated from these statements. The government-wide focus is more on operational efficiency, the sustainability of the City as an entity and the change in the City's net assets resulting from the current year's activities.

The Internal Service fund is consolidated into the governmental column when presented at the government-wide level. This is because the principal users of the internal service are the City's governmental activities. The net profit/loss in the internal service fund is allocated to the functional activity (public safety, public works, etc.) based upon usage.

In the government-wide Statement of Net Assets, both the governmental and business-type activities are presented on a consolidated basis. Due to the full accrual, economic resource basis, all long-term assets and receivables, as well as long-term debt and obligations are recognized. The City's net assets are reported in three parts – invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The City first utilizes restricted resources to finance qualifying activities.

The government-wide Statement of Activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. This statement reduces gross expenses (including depreciation) by related program revenues, which includes charges for services, operating grants and capital grants.

The program revenues must be directly associated with the function. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported as general revenue.

BASIC FINANCIAL STATEMENTS – FUND FINANCIAL STATEMENTS

The financial transactions of the City are reported in individual funds in the fund financial statements. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. The focus of the fund financial statement is upon the determination of financial position and changes in financial position (sources, uses, and balances of financial resources).

Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The emphasis in the fund financial statements is on the major funds in the governmental or business-type categories. GASBS No. 34 sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses of the governmental and proprietary funds) for the determination of major funds.

Governmental Funds

The following is a description of the major governmental funds of the City:

General Fund – The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

BASIC FINANCIAL STATEMENTS — FUND FINANCIAL STATEMENTS – CONTINUED

Major and Local Street Funds – The Street Funds account for the operation of the street departments. Primary financing is provided by the City's share of state gasoline taxes. State law requires these gasoline taxes to be used to maintain streets.

Income Tax Fund – The Income Tax Fund accounts for the proceeds from the City income tax collections. These collections are reserved for capital improvements.

In addition, the City reports the following non-major governmental funds:

Debt Service Fund – The Debt Service fund accounts for the payment of interest and principal on long-term obligations.

Proprietary Funds

The focus of the proprietary funds is upon the determination of operating income, changes in fund net assets, financial position, and cash flows, which is similar to for-profit businesses. The following is a description of the major proprietary fund of the City:

Water and Sewer Fund – The Water and Sewer Fund is an Enterprise Fund. The fund is financed and operated in a manner similar to a private enterprise. The intent is that costs (expenses, including depreciation) of providing water and sewer services to the general public are recovered through user charges.

In addition, the City reports the following non-major proprietary funds:

Motor Vehicle and Equipment Fund – The Motor Vehicle and Equipment Fund is an internal service fund. This fund accounts for the cost of acquiring, maintaining and providing vehicle and equipment usage to various City departments.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operation. The principal operating revenues of the Water and Sewer and the Motor Vehicle and Equipment Funds are charges to customers for sales and services. Operating expenses for these funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the City in a trustee or agent capacity. Since, by definition, these assets are being held for the benefit of a third party (other local governments, private parties, pension participants, etc.) and cannot be used to address activities or obligations of the government, these funds are not incorporated into the government-wide statements. All trust funds employ the same economic resources measurement focus and accrual basis of accounting, as do proprietary funds. Agency funds use the accrual basis of accounting, however, report only assets and liabilities. The following is a description of the fiduciary fund maintained by the City.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

BASIC FINANCIAL STATEMENTS — FUND FINANCIAL STATEMENTS – CONTINUED

Agency Fund – The Agency Fund accounts for the collection and payments of property tax levies.

BASIS OF ACCOUNTING

Basis of accounting refers to the point at which revenues and expenditures/expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The government-wide statements are reported using the economic resources measurement focus and the full accrual basis of accounting, which incorporates long-term assets and receivables as well as long-term debt and obligations. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. Expenditures generally are recorded when a liability is incurred.

All proprietary and agency funds are accounted for using the full accrual basis of accounting. Their revenues are recognized when they are earned and their expenses are recognized when they are incurred. Unbilled water and sewer utility service receivables are recorded at year-end.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded in the accounting period in which they are earned, as long as they are both available and measurable. Revenues are available when received within the current period or within 60 days after year end. Expenditures are recorded in the accounting period in which the liability is incurred, as under full accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY

Cash and Cash Equivalents

Cash and cash equivalents are considered to be cash on hand and demand deposits.

Inventory

Inventory is valued at cost, which approximates market, using the first-in, first-out method.

Interfund Receivables/Payables

Outstanding balances between funds are reported as "due to/from" other funds on the balance sheet of the fund financial statements and as "internal balances" on the Statement of Net Assets of the government-wide financial statements.

Capital Assets

Capital assets, which include property, buildings, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items) are reported in the applicable governmental or business-type activities column in the government-wide financial statements.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY – CONTINUED

Capital assets are recorded by the City when the initial individual costs are equal to or greater than the following amounts:

<u>Asset Type</u>	<u>Amount</u>
Land	\$ 1
Equipment	1,000
Buildings	1,000
Infrastructure	1,000

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Property, buildings and equipment are depreciated using the straight-line method over the following useful lives:

Buildings	40 to 60 years
Building Improvements	15 to 30 years
Water and Sewer Lines	50 to 75 years
Streets, Curbs and Gutters	10 to 30 years
Vehicles	3 to 5 years
Office Equipment	5 to 7 years

Long-Term Obligations

In the government-wide financial statements and the proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Compensated Absences (Vacation and Sick Time)

All vacation, sick pay, and other employee benefit amounts accrue when earned in the government-wide and proprietary fund financial statements. Sick and vacation pay are recognized in the governmental financial statements when a payment is made.

Fund Equity

In the fund financial statements, governmental funds report reserved fund balances for amounts that are not available for appropriation or are legally restricted by outside parties for specific purposes. Designations of fund balance represent tentative management plans that are subject to change.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

COMPARATIVE DATA

Comparative data for the prior year is not included in the City's financial statements.

NOTE 2: STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all operating funds of the City except for the agency fund. Budgetary control is legally maintained at the fund level.

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to the first Council meeting in May, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures/expenses and the means of financing them.
2. A public hearing is conducted at City Hall to obtain taxpayer comments.
3. Prior to July 1, the fund budgets are legally enacted through passage of resolutions.
4. The City Manager is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures/expenses of any fund must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device during the year for the General and Special Revenue Funds.
6. Budgeted amounts are as originally adopted, or as amended by the City Council.
7. Encumbrances, which are commitments related to unperformed contracts for goods or services, lapse at year-end and are re-appropriated as part of the subsequent year's budget.

Excess of Expenditures Over Appropriations in Budgeted Funds

The City is required under Public Act 621 to adopt a budget for the General and Special Revenue Funds. The City did not incur an excess of expenditures over appropriations for the General or Special Revenue Funds.

NOTE 3: CASH AND INVESTMENTS

Michigan Compiled Laws, Section 129.91, authorizes the City to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations which have an office in Michigan. The City is allowed to invest in bonds, securities and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan.

The City's deposits and investment policy are in accordance with statutory authority.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 3: CASH AND INVESTMENTS – CONTINUED

Cash Deposits

At June 30, 2006, the carrying amount of the City's deposits, including the fiduciary fund, was \$3,273,373 and the bank balance was \$3,579,775.

Pooling of Cash - The City pools cash to maximize its investment return.

<u>Fund</u>	<u>Pooled Cash</u>
Primary Government	
General	\$ 1,074,429
Major Street	117,038
Local Street	8,686
Water Fund	96,857
Sewer Fund	386,727
Internal Service Fund	205,372
Income Tax Fund	37,787
	<hr/>
Total pooled cash	1,926,896
Cash not held in pooled accounts:	<hr/>
	1,346,477
	<hr/>
Total Cash	<u>\$ 3,273,373</u>

Investments

Custodial Credit Risk- Deposits. Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The City's investment policy limits deposits to Certificates of Deposit (CDs), savings accounts with banks, savings and loan associations, and credit unions which are insured with the applicable federal agency. As of June 30, 2006, \$2,368,539 of the City's bank balance of \$3,273,373 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized \$ 2,368,539

As of June 30, 2006, the City had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Weighted Average Maturity (Years)</u>
Certificates of Deposit	\$ 835,102	1.5
Federal National Mortgage Association	<u>92,204</u>	1.0
	<hr/>	
Total fair value	<u>\$ 927,306</u>	

Many of the above investments, including CDs and bonds, are presently callable or callable prior to maturity.

Credit Risk. State law limits investments in bonds, securities and other obligations of the United States or an agency or instrumentality of the United States, state obligations or obligations of any of its political subdivisions (rated as investment grade by not less than 1 standard rating service), investment pools organized under the local government investment pool act, mutual funds, U.S. or agency repurchase agreements, bankers' acceptances of United States banks, and commercial paper (rated to the top 2 ratings at the time of purchase established by not less than 2 standard rating services and that matures not more than 270 days after the date of purchase). The City's policy does not further limit its investment choices.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 4: PROPERTY TAXES

Property taxes are levied and become a lien on property as of July 1 on the State taxable valuation of property in the City as of the preceding December 31. The City bills and collects its own property taxes and also collects taxes for other governmental units. Collection of other governmental unit's taxes and remittance of them to the units are accounted for in the Agency Fund. Property taxes are recognized as revenue in the year for which they are levied.

The City is permitted by charter to levy taxes, subject to State Headlee and Truth in Taxation provisions, up to \$20 per \$1,000 of taxable valuation for general governmental services and for the payment of principal and interest on general obligation long-term debt. The 2005 State taxable valuation of the City of Grayling totaled \$ 53,924,565.

The tax rate for the year ended June 30, 2006, was as follows:

<u>Purpose</u>	<u>Rate/Taxable Valuation</u>
General governmental services	14.8000 per \$1,000

NOTE 5: INTERFUND RECEIVABLES AND PAYABLES

The interfund balances within the primary government are as follows:

	<u>Interfund Receivable</u>	<u>Interfund Payable</u>
General Fund	\$ 31,165	\$ -
Income Tax Fund	-	31,120
Fiduciary Fund	-	45
	<u>\$ 31,165</u>	<u>\$ 31,165</u>

The interfund balances are for interest due on property taxes, construction projects, and for grant money restricted for street use.

NOTE 6: INTERFUND TRANSFERS

Operating transfers within the primary government are as follows:

	<u>Transfer In</u>	<u>Transfer Out</u>
General Fund	\$ 41,605	\$ 164,669
Local Street Fund	195,705	-
Income Tax Fund	-	223,434
Water and Sewer Fund	43,000	-
Other Nonmajor Govt. Funds	101,432	-
Internal Service Fund	6,361	-
	<u>\$ 388,103</u>	<u>\$ 388,103</u>

The operating transfers are mainly for street improvements, general city operations, debt service and capital improvements.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 7: CAPITAL ASSETS

Capital asset activity of the City's primary government for the current year was as follows:

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Governmental Activities				
Capital assets not being depreciated:				
Land	\$ 148,421	\$ 67,343	\$ -	\$ 215,764
Construction in progress	205,382	44,195	167,867	81,710
Subtotal	<u>353,803</u>	<u>111,538</u>	<u>167,867</u>	<u>297,474</u>
Capital assets being depreciated:				
Buildings	2,104,939	31,742	-	2,136,681
Equipment	2,740,840	101,689	-	2,842,529
Infrastructure	<u>7,812,574</u>	<u>283,172</u>	<u>-</u>	<u>8,095,746</u>
Subtotal	<u>12,658,353</u>	<u>416,603</u>	<u>-</u>	<u>13,074,956</u>
Less accum. depreciation:				
Buildings	462,714	43,199	-	505,913
Equipment	1,143,474	156,342	-	1,299,816
Infrastructure	<u>5,550,621</u>	<u>186,862</u>	<u>-</u>	<u>5,737,483</u>
Subtotal	<u>7,156,809</u>	<u>386,403</u>	<u>-</u>	<u>7,543,212</u>
Net capital assets being depreciated	<u>5,501,544</u>	<u>30,200</u>	<u>-</u>	<u>5,531,744</u>
Governmental activities net capital assets	<u>\$ 5,855,347</u>	<u>\$ 141,738</u>	<u>\$ 167,867</u>	<u>\$ 5,829,218</u>

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 7: CAPITAL ASSETS – CONTINUED

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Business-type Activities				
Capital assets not being depreciated:				
Construction in progress	\$ 412,859	\$ 428,359	\$ 265,789	\$ 575,429
Capital assets being depreciated:				
Equipment	8,054,575	550,690	-	8,605,265
Less accum. depreciation:				
Equipment	2,868,104	160,068	-	3,028,172
Net capital assets being depreciated	5,186,471	390,622	-	5,577,093
Governmental activities net capital assets	<u>\$ 5,599,330</u>	<u>\$ 818,981</u>	<u>\$ 265,789</u>	<u>\$ 6,152,522</u>

Depreciation expense was charged to the primary government as follows:

Governmental Activities

General government	\$ 60,770
Public safety	99,468
Public works	22,047
Highways and streets	199,388
Culture and recreation	4,730
Total governmental activities	<u>\$ 386,403</u>

Business-type Activities

Water and sewer	<u>\$ 160,068</u>
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NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 7: CAPITAL ASSETS – CONTINUED

Construction Commitments

The City has active construction projects at year-end. The projects include:

	Project Estimates	Expended to 06/30/06	Committed
Stormwater Project	\$ 1,013,937	\$ 575,428	\$ 71,525
River Park Development	584,288	81,710	510,868
	<u>\$ 1,598,225</u>	<u>\$ 657,138</u>	<u>\$ 582,393</u>

At year-end, significant construction in progress amounts are capitalized.

Proprietary Fund Type Property, Plant and Equipment

Proprietary fund type property, plant and equipment at June 30, 2006 are summarized as follows:

	Enterprise	Internal Service
Construction in progress	\$ 575,429	\$ -
Water and sanitary sewer system	8,605,265	-
Equipment	-	1,013,833
Total	9,180,694	1,013,833
Less: accumulated dep.	(3,028,172)	(452,668)
Net	<u>\$ 6,152,522</u>	<u>\$ 561,165</u>

NOTE 8: DEFERRED COMPENSATION PLAN

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code 457. The plan, available to all City employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

In complying with the amended Section 457 requirements, these assets are now for the exclusive benefit of participants and not subject to the claims of the City's general creditors. As such, they are no longer included in an agency fund of the City.

NOTE 9: DEFINED CONTRIBUTION PLAN

The City provides pension benefits for employees as designated by City Council through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. As of July 1, 2004, employees are eligible to participate from the date of employment. The City's contributions for each employee (and interest allocated to each employee's account) are fully vested after four years.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 9: **DEFINED CONTRIBUTION PLAN - CONTINUED**

As established by City Council and governed by Federal regulations, the City made the required 11.00% contribution. The City contributed 12.00% for the City Manager. Contributions for the year totaled \$ 19,076 for the eight employees that participated in this plan. There are no contribution requirements for employees of the City of Grayling.

NOTE 10: **DEFINED BENEFIT PENSION PLAN**

Plan Description

The City of Grayling participates in the Michigan Municipal Employees' Retirement System (MERS), an agent multiple-employer defined benefit pension plan that covers all employees of the City of Grayling. MERS was established by the State of Michigan for purposes of providing retirement, survivor and disability benefits on a voluntary basis to the State's local government employees. MERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Municipal Employees Retirement System of Michigan, 447 North Canal, Lansing, Michigan 48917.

Funding Policy

There are no contribution requirements for members of the City of Grayling. The City is required to contribute all amounts necessary to fund the system using the actuarial basis specified by statute. The contribution requirements of plan members and the City are established and may be amended by the MERS board.

Annual Pension Cost

For the year ended June 30, 2006, the City's required and actual contributions were \$ 76,517. The annual required contribution was determined as part of an actuarial valuation at December 31, 2005. The actuarial assumptions included (a) 8% investment rate of return (net of administrative expenses), (b) projected salary increases of 4.50% per year compounded annually, attributable to inflation, (c) additional projected salary increases of 0.0% to 4.50% per year, based on age, attributable to seniority/merit and, (d) the assumption that benefits will increase 2.5% per year (annually) after retirement, for persons under Benefit E-1 or E-2. The contribution rate for normal cost is determined using an entry age actuarial funding method. MERS uses the level percentage of payroll method to amortize the unfunded liability over a 30 year period on a closed basis.

Three-Year Trend Information for the City of Grayling

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
06-30-04	\$ 64,676	100%	-
06-30-05	73,160	100%	-
06-30-06	76,517	100%	-

Additional trend information may be found within the Required Supplemental Information section of the financial statements.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 11: OTHER POST-EMPLOYMENT BENEFITS

The City provides post-employment benefits of health insurance to eligible employees. For the year ended June 30, 2006, there was one participant. The City's actual expense was \$9,350.

NOTE 12: LONG-TERM DEBT

The following is a summary of the City's long-term debt transactions for the year ended June 30, 2006:

	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due Within One Year
Governmental Activities					
Bonds and notes payable:					
General obligation debt	\$ 850,000	\$ -	\$ 30,000	\$ 820,000	\$ 30,000
Installment notes	-	220,357	21,148	199,209	41,387
Total bonds and notes payable	850,000	220,357	51,148	1,019,209	71,387
Compensated absences	51,149	2,538	-	53,687	-
Total governmental activities long-term liabilities	<u>\$ 901,149</u>	<u>\$ 222,895</u>	<u>\$ 51,148</u>	<u>\$ 1,072,896</u>	<u>\$ 71,387</u>
Business-type Activities					
Revenue obligation debt	<u>\$ 1,626,000</u>	<u>\$ -</u>	<u>\$ 32,000</u>	<u>\$ 1,594,000</u>	<u>\$ 32,000</u>

Long-term liabilities payable at June 30, 2006, is composed of the following individual issues:

Bond and Note Obligations (Governmental Activities):

\$900,000, 2003 General Obligation bonds due in annual installments of \$30,000 to \$75,000 through August 1, 2022, interest at 2.00% to 5.00%.

\$ 820,000

\$220,357, 2006 Installment note due in quarterly installments of \$41,387 to \$46,362 through November 2010, interest at 3.750%.

199,209

Total governmental activities bond and note obligations

1,019,209

Compensated Absences

53,687

Total governmental activities long-term liabilities

\$ 1,072,896

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 12: LONG-TERM DEBT – CONTINUED

Revenue Obligation (Business-type Activities):

\$1,140,000, 1991A Water and Sewer bonds due in annual installments of \$19,000 to \$65,000 through July 1, 2030, interest at 5%.

\$ 948,000

\$777,000, 1991B Water and Sewer bonds due in annual installments of \$13,000 to \$445,000 through July 1, 2030, interest at 5%.

646,000

Total business-type activities long-term liabilities

\$ 1,594,000

The annual requirements to amortize all general and revenue obligation bonds and notes outstanding, as of June 30, 2006, are as follows:

Annual Requirements to Amortize Outstanding Bonds June 30, 2006

Year Ending June 30	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2007	\$ 71,387	\$ 42,074	\$ 32,000	\$ 78,900
2008	72,971	39,771	34,000	77,250
2009	79,641	37,177	37,000	75,475
2010	81,362	34,326	38,000	73,600
2011	58,848	30,743	40,000	71,650
2012-2016	220,000	130,218	234,000	325,250
2017-2021	290,000	72,646	300,000	258,750
2022-2026	145,000	7,340	384,000	173,650
2026-2031	-	-	495,000	64,375
Total	<u>\$ 1,019,209</u>	<u>\$ 394,295</u>	<u>\$ 1,594,000</u>	<u>\$ 1,198,900</u>

NOTE 13: DESIGNATED FUND BALANCES/RESTRICTED NET ASSETS

Major Governmental Funds

The General Fund has \$937,742 designated for the cemetery, fire protection and unfunded pension liabilities.

The Income Tax Fund has \$432,488 designated for future capital improvement projects.

Major Proprietary Funds

The Water Fund has \$13,620 of its net assets restricted due to revenue bond indentures and \$47,300 for capital improvements. The sewer fund has \$25,760 of its net assets restricted due to bond indentures and \$23,800 for capital improvements.

NOTES TO FINANCIAL STATEMENTS – CONTINUED

NOTE 14: CONTINGENCIES

The General Fund is contingently liable for the Water and Sewer System revenue bonds. The General Fund is obligated only if revenues of the Water and Sewer System Fund would be insufficient to meet its debt service requirements.

NOTE 15: RISK MANAGEMENT

The City is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. The City belongs to the Michigan Municipal League Liability and Property Pool, a public entity risk pool currently operating as a common risk management and insurance program for various municipalities throughout the state. The City pays an annual premium for its general insurance coverage. The pool is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of \$500,000 for each insured event. Although the City could be assessed charges beyond the annual premium, the likelihood of receiving such an assessment is minimal. Settled claims have not exceeded coverage in any of the past three years.

NOTE 16: COMMITMENTS

The City has a contract with the Michigan Department of Transportation for improvements along the I-75 corridor. Approximately \$60,000 remains on this commitment at year-end.

NOTE 17: PRIOR PERIOD ADJUSTMENT

A prior period adjustment was made to properly reflect prior year state shared revenue of \$44,496.

REQUIRED SUPPLEMENTAL INFORMATION

CITY OF GRAYLING
Required Supplemental Information
Defined Benefit Pension Plan
Trend Information
For the Year Ended June 30, 2006

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAI) (b-o)	Funded Ratio (a/b)	Covered Payroll (c)	UAAI as a Percentage of Covered Payroll ((b-a)/c)
12/31/03	\$	\$ 1,705,623	\$ 1,965,919	86.8%	\$ 582,557	44.7%
12/31/04		1,735,029	2,128,351	81.5%	593,426	66.3%
12/31/05		1,828,977	2,246,512	81.4%	642,803	65.0%

Schedule of Employer Contributions

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed
06/30/04	\$ 64,676	100%
06/30/05	73,160	100%
06/30/06	76,517	100%

See accompanying notes to the basic financial statements.

OTHER SUPPLEMENTAL INFORMATION

CITY OF GRAYLING
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Nonmajor Governmental Funds
For the Year Ended June 30, 2006

	Debt Service
	<u> </u>
Revenues	\$ -
	<u> </u>
Expenditures	
Debt service:	
Interest	43,164
Principal retirement	58,268
	<u> </u>
Total expenditures	101,432
	<u> </u>
Excess (deficiency) of revenues over expenditures	(101,432)
	<u> </u>
Other financing sources (uses)	
Operating transfers in	101,432
	<u> </u>
Net change in fund balances	-
	<u> </u>
Fund balances - beginning	-
	<u> </u>
Fund balances - ending	<u><u>\$ -</u></u>

City of Grayling
Schedule of Bonded Indebtedness
June 30, 2006

	Date of Issue	Amount of Issue	Interest Rate	Due Date	Total Outstanding June 30, 2006	Semi-Annual Interest Payable
General Obligation Limited Tax Bonds, Series 2003A	February 4, 2003	\$ 900,000	2.20%	8/1/2006	\$ 30,000	\$ 17,705
			2.20%	2/1/2007		17,375
			2.60%	8/1/2007	30,000	17,375
			2.60%	2/1/2008		16,985
			3.05%	8/1/2008	35,000	16,985
			3.05%	2/1/2009		16,451
			3.40%	8/1/2009	35,000	16,451
			3.40%	2/1/2010		15,856
			3.75%	8/1/2010	35,000	15,856
			3.75%	2/1/2011		15,200
			4.00-5.00%	Thereafter	655,000	210,203
					<u>\$ 820,000</u>	<u>\$ 376,442</u>

Call provision:

Optional Prior Redemption: The bonds maturing on or before August 1, 2012 are not subject to redemption prior to maturity.

Bonds or portions of bonds in multiples of \$5,000 maturing on or after August 1, 2013 shall be subject to redemption without a premium, at the option of the City, in such order as the City shall determine and within any maturity by lot, on any interest payment date on or after August 1, 2012, at par and accrued interest to the date fixed for redemption.

City of Grayling
Schedule of Bonded Indebtedness
June 30, 2006

	<u>Date of Issue</u>	<u>Amount of Issue</u>	<u>Interest Rate</u>	<u>Due Date</u>	<u>Total Outstanding June 30, 2006</u>	<u>Semi-Annual Interest Payable</u>
Revenue Bonds:						
Water Supply and Sewage	June 28, 1991	\$ 1,140,000	5.00%	7/1/2006	\$ 19,000	\$ 23,700
Disposal System Junior				1/1/2007		23,225
Lien Revenue Bond,				7/1/2007	20,000	23,225
Series 1991A				1/1/2008		22,725
				7/1/2008	22,000	22,725
				1/1/2009		22,175
				7/1/2009	23,000	22,175
				1/1/2010		21,600
				7/1/2010	24,000	21,000
				1/1/2011		20,375
				Thereafter	840,000	490,225
					<u>\$ 948,000</u>	<u>\$ 713,150</u>

Call provision:

Bonds shall be subject to redemption prior to maturity at the option of the City in inverse chronological order, on any interest payment date, at par and accrued interest to the date fixed for prepayment.

In addition, principal installments of this bond are subject to prepayment upon the request of R.E.C.D. (the bond holder) if at any time it should appear to R.E.C.D. that the City is able to refinance this bond by obtaining a loan for such purposes from responsible cooperative or private sources at reasonable rates and terms.

City of Grayling
Schedule of Bonded Indebtedness
June 30, 2006

Revenue Bonds:

	Date of Issue	Amount of Issue	Interest Rate	Due Date	Total Outstanding June 30, 2006	Semi-Annual Interest Payable
Water Supply and Sewage Disposal System Junior Lien Revenue Bond, Series 1991B	June 28, 1991	\$ 777,000	5.00%	7/1/2006	\$ 13,000	\$ 16,150
				1/1/2007		15,825
				7/1/2007	14,000	15,825
				1/1/2008		15,475
				7/1/2008	15,000	15,475
				1/1/2009		15,100
				7/1/2009	15,000	15,100
				1/1/2010		14,725
				7/1/2010	16,000	14,725
				1/1/2011		13,900
	Thereafter				573,000	333,450
					<u>\$ 646,000</u>	<u>\$ 485,750</u>

Call provision:

Bonds shall be subject to redemption prior to maturity at the option of the City in inverse chronological order, on any interest payment date, at par and accrued interest to the date fixed for prepayment.

In addition, principal installments of this bond are subject to prepayment upon the request of R.E.C.D. (the bond holder) if at any time it should appear to R.E.C.D. that the City is able to refinance this bond by obtaining a loan for such purposes from responsible cooperative or private sources at reasonable rates and terms.

FEDERAL SINGLE AUDIT REPORTING



October 31, 2006

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Honorable Mayor, Members of
City Council and City Manager
City of Grayling, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Grayling, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the City of Grayling's basic financial statements and have issued our report thereon dated October 31, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered City of Grayling's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether City of Grayling's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

City of Grayling
Grayling, Michigan

We noted certain matters that we reported to management of the City of Grayling, in a separate letter dated October 31, 2006.

This report is intended solely for the information and use of the audit committee, management, City Council, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Hill, Schroeder & Co.

CERTIFIED PUBLIC ACCOUNTANTS
Petoskey, Michigan

CITY OF GRAYLING
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2006

Federal Grantor Pass-through Grantor Program Title	Federal CFDA Number	Federal Expenditures
U.S. Department of Housing and Urban Development		
Pass-through programs from the State of Michigan:		
Community Development Block Grant/State's Program	14.228	\$ 168,386
U.S. Department of Agriculture		
Pass-through program from the State of Michigan:		
Rural Business Enterprise Grant	10.769	<u>15,360</u>
Total expenditures of Federal Awards		<u><u>\$ 183,746</u></u>

NOTE – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the Federal grant activity of the City of Grayling and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the basic financial statements.

CITY OF GRAYLING
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
For the Year Ended June 30, 2006

Finding/Noncompliance

There were no material findings or questioned costs in the prior year.

CITY OF GRAYLING
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended June 30, 2006

Summary of Audit Results

1. The City of Grayling has received an unqualified opinion on its financial statements.
2. We noted no matters in the City's internal control structure, which we considered to be reportable conditions.
3. We noted no noncompliance that would be material to the financial statements.
4. We noted no matters in the City's internal control over its federal programs, which we consider to be reportable conditions.
5. The City has received an unqualified opinion on compliance for its federal programs.
6. We noted no audit findings required to be reported under Section 510 (a) of OMB Circular A-133.
7. The City has no major programs.
8. The threshold used for distinguishing between Type A and B programs was \$300,000.
9. The City qualified as a low-risk auditee.

Findings and Questions Costs

We noted no material findings, or questioned costs.